



STATE BOARD OF EQUALIZATION

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Fourth District, Los Angeles

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State Controller

RAMON J. HIRSIG  
Executive Director

May 9, 2008

Dear Interested Party:

Enclosed is the Initial Discussion Paper on Regulation 1705, *Relief from Liability*. Discussion regarding proposed amendments to Regulation 1705 is scheduled for the Board's September 16, 2008, **Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 10:00 a.m. on May 20, 2008**, at the Board of Equalization; 450 N Street; Sacramento, California.

If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the May 20, 2008 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on May 20, 2008, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Lynn Whitaker at (916) 324-8483 or by e-mail at [Lynn.Whitaker@boe.ca.gov](mailto:Lynn.Whitaker@boe.ca.gov) prior to May 13, 2008. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing. In addition, please let Ms. Whitaker know if you wish to have future correspondence, including the second discussion paper and all attachments, sent to your e-mail address rather than to your mailing address.

Whether or not you are able to attend the above interested parties' meeting, please keep in mind that the due date for interested parties to provide written responses to staff's analysis is **June 6, 2008**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Hellmuth, Supervisor, Business Taxes Committee Team at (916) 322-5271.

Sincerely,

Jeffrey L. McGuire  
Chief, Tax Policy Division  
Sales and Use Tax Department

JLM: llw

Enclosures

cc: (all with enclosures)

Honorable Judy Chu, Ph.D., Chair, Fourth District  
Honorable Betty T. Yee, Vice Chairwoman, First District (MIC 71)  
Honorable Bill Leonard, Member, Second District (MIC 78)  
Honorable Michelle Steel, Member, Third District  
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel (via e-mail)  
Mr. Mark Ibele, Board Member's Office, Fourth District (via e-mail)  
Mr. Steve Shea, Board Member's Office (*3 copies*), Fourth District (via e-mail)  
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)  
Ms. Sabina Crocette, Board Member's Office, First District (via e-mail)  
Mr. Gary Qualset, Board Member's Office, First District (via e-mail)  
Mr. Mengjun He, Board Member's Office, First District (via e-mail)  
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)  
Mr. Erik Caldwell, Board Member's Office, Third District (via e-mail)  
Mr. Ken Maddox, Board Member's Office, Third District (via e-mail)  
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)  
Ms. Elizabeth Maeng, Board Member's Office, Third District (via e-mail)  
Ms. Christina Rueck, Board Member's Office, Third District (MIC 77)  
Ms. Melanie Darling, State Controller's Office (via e-mail)  
Mr. Ramon J. Hirsig (via e-mail)  
Ms. Kristine Cazadd (via e-mail)  
Ms. Randie L. Henry (via e-mail)  
Mr. Jeff Vest (via e-mail)  
Mr. David Levine (via e-mail)  
Mr. Randy Ferris (via e-mail)  
Ms. Windie Scott (via e-mail)  
Ms. Christine Bisauta (via e-mail)  
Ms. Trecia Nienow (via e-mail)  
Mr. Todd Gilman (via e-mail)  
Ms. Lauren Simpson (via e-mail)  
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Ms. Lauren Simpson (via e-mail)  
Mr. Dave Hayes (via e-mail)  
Ms. Freda Orendt (via e-mail)  
Mr. Stephen Rudd (via e-mail)  
Mr. Joseph Young (via e-mail)  
Mr. James Kuhl (via e-mail)  
Mr. Geoffrey E. Lyle (via e-mail)  
Ms. Leila Hellmuth (via e-mail)  
Ms. Lynn Whitaker (via e-mail)  
Ms. Cecilia Watkins (via e-mail)

## **INITIAL DISCUSSION PAPER**

### **Proposed revisions to Regulation 1705, *Relief from Penalty*, regarding RTC section 6596 relief to franchisees based on written advice provided to franchisors**

#### **Issue**

Whether to revise Regulation 1705 to clarify that a franchisee is relieved from the liability to pay tax based on erroneous written advice provided to its franchisor.

#### **Background**

Revenue and Taxation Code section (Section) 6596 provides relief from tax, interest, and penalty charges due on a transaction if the Board determines that the taxpayer failed to pay tax because it reasonably relied on erroneous written advice from the Board. For relief to apply, the Board must have received a written request for advice on the transaction, the request must have identified the taxpayer to whom the advice applied, and the request must have fully described the facts and circumstances of the transaction.

Section 6596 subdivision (d) states that, “[o]nly the person making the written request shall be entitled to rely on the board’s written advice to that person.” Accordingly, taxpayers cannot obtain relief by relying on a written opinion given to another business, even if the transactions are similar. However, a person may rely on advice given to the person’s representative provided that the representative identifies the person for whom the advice is requested.

Regulation 1705, *Relief from Liability*, is based upon Section 6596 and explains its provisions in more detail. In 1999, Regulation 1705 was amended to extend Section 6596 relief to trade or industry association members when an association requests written advice on behalf of its members. In order to obtain relief under Section 6596, the members must be identified in the association’s request for advice. Subdivision (e) of Regulation 1705 provides:

(e) **TRADE OR INDUSTRY ASSOCIATIONS.** A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.

Under discussion is whether similar relief should be provided to franchisees that relied on written advice provided to their franchisor. This issue was brought up by an interested party at the September 12, 2007 public hearing on the proposed Board of Equalization Rules for Tax Appeals. The Business Taxes Committee is scheduled to discuss this topic at the September 16, 2008 Committee meeting.

#### **Discussion**

Staff proposes to revise subdivision (e) of Regulation 1705 to clarify that the provisions of the regulation apply to a franchisee’s relief from liability to pay tax based on written erroneous advice provided to the franchisor.

## **INITIAL DISCUSSION PAPER**

### **Proposed revisions to Regulation 1705, *Relief from Penalty*, regarding RTC section 6596 relief to franchisees based on written advice provided to franchisors**

#### Written advice provided in response to a franchisor's written request

Currently, Regulation 1705 does not specifically address Section 6596 relief from liability for franchisees on the basis of written advice provided to a franchisor. Subdivision (b)(1) of Regulation 1705, however, does address relief for persons for whom the advice is requested, provided such persons are specifically identified in the written inquiry. Thus, staff believes that under the current regulation a franchisee could be relieved of the liability for tax if its franchisor requested written advice and identified the franchisee. However, to provide clarity in the regulation, staff proposes revising subdivision (e) of Regulation 1705 to specifically address franchisors and franchisees. The proposed revisions should also explain that in order to qualify for relief, the activity, or transactions in question must involve the same facts and circumstances as those presented in the request for relief from the association or franchisor. Staff's proposed revisions to Regulation 1705 are attached in Exhibit 1.

#### Written advice provided in an audit of a franchisor

The term "written advice" includes written advice provided in an audit. It should be noted that erroneous advice provided in the audit of a franchisor or franchisee would generally not relieve other franchisees from liability even if they had similar transactions. Subdivision (a)(3) of Regulation 1705 explains that written advice provided in the audit report may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Thus, written advice provided in the audit of a franchisor would only provide relief from liability for that franchisor (or a legal or statutory successor to that franchisor). Although franchisees may have similar transactions, they are not a party to the audit and are not provided relief based on reliance on the written information in the audit. If a franchisor questions how tax applies to a transaction, the franchisor should send the Board a written request for advice describing the transaction and identifying its franchisees.

#### **Summary**

Staff proposes amendments to Regulation 1705 to clarify a franchisee's relief from liability to pay tax based on erroneous advice provided to the franchisor. Staff welcomes any comments, suggestions, and input from interested parties regarding this issue.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 05/08/2008

**Regulation 1705. RELIEF FROM LIABILITY.**

Reference: Section 6596, Revenue and Taxation Code.

**(a) IN GENERAL.** A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

- (1) Written advice given by the Board under the conditions set forth in subdivision (b) below; or
- (2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or
- (3) Written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

**(b) ADVICE PROVIDED IN A WRITTEN COMMUNICATION.**

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

- (A) The defined population of the purchases that will be included in the reporting method;
- (B) The percentage of purchases of the defined population that is subject to tax;
- (C) The length of time the writing shall remain in effect;
- (D) The definition of a significant or material change that will require rescinding the approved reporting method; and
- (E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

**(c) WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT.** Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit

comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

**(d) ANNOTATIONS AND LEGAL RULINGS OF COUNSEL.** Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

**(e) TRADE OR INDUSTRY ASSOCIATIONS OR FRANCHISORS.** A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must also identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.